

**Testimony of William R. Hawkins**  
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**U.S.-China Commission Hearing on U.S. Export Controls**  
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My name is William R. Hawkins, Senior Fellow for National Security Studies at the United States Business and Industry Council. I would like to thank the U.S.-China Commission for allowing me the opportunity to express the many concerns of my organization regarding the risks inherent in the transfer of technology to the People's Republic of China. My organization has represented since 1933 domestic manufacturers and other small and medium-sized businesses. The USBIC has championed policies that we believe serve the interests of our roughly 1,000 member companies and the nation at large, ensuring that the United States retains at home a manufacturing base capable of safeguarding our national security and ensuring broad-based, solidly grounded prosperity.

Our members come from many different sectors of the economy, some of which are involved in defense sub-contracting or high-tech production, and many which have been impacted by Chinese or China-based competition. The USBIC is not, however, a trade association in the usual sense. The USBIC has distinguished itself from other business groups by its support for an active foreign policy and a strong national defense which goes above and beyond the specific interests of our member companies. Our business leaders still adhere to the principle that policies that work to maintain America's preeminence in world affairs are ultimately good from them as Americans.

Thus, when we look at the question of whether the flow of technology to China should be encouraged or restricted, we do so from the perspective of what Beijing is likely to do with any new capabilities in terms of posing a threat to the United States. Among the reasons the U.S. has export controls is to curtail the development and proliferation of weapons of mass destruction (nuclear, chemical, biological) and their means of delivery (especially missiles); to protect encryption methods; and to maintain regional conventional military balances consistent with American interests. All of these elements pertain to China.

We feel that China is fundamentally different from most other countries with which America has economic dealings in that Beijing, under its one-party Communist state, uses the gains from trade to support policies that are at odds with American values and interests around the world. We believe China is the country most likely to become a peer competitor to the United States in the coming decades, and that it is vital that America maintain as large a technological lead over China as possible.

Beijing's objective, of course, is to narrow that gap. Last week, China's Foreign Minister Li Zhaoxing urged the U.S. to remove restrictions on high-tech exports to China. "We hope the U.S. side will earnestly deal with China's concerns and relax restrictions of high technological

exports to China, oppose legislation influencing normal trade cooperation and work together to develop healthy Sino-US trade relations,” Li told journalists on March 7. He went on to say “Some American friends are complaining that China's trade surplus with the United States is too big. But the reasons behind the surplus are complicated... there are some very expensive things that they don't sell like items with high technological content that have dual civilian and military uses.” He tried to place this question entirely in the sphere of private commerce, even though it would most assuredly involve state-owned Chinese firms in aerospace and related strategic sectors of the economy. Li claimed, “Sometimes we don't need to politicize some issues, it is better to follow the norms of the World Trade Organization.”<sup>1</sup>

Li's statement is wrong in principle and misstates WTO norms. Article XXI of the 1994 GATT places “the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment” outside the regular rules of international commerce because such trade is inherently bounded by international politics and national security concerns.

The Chinese line that easing security-related export controls would help balance the massive and growing U.S. trade deficit with China has been consistent for many years. In an interview with the *Financial Times* just before Thanksgiving in 2004, Li Ruogu, the deputy governor of the People's Bank of China, warned the U.S. not to blame other countries for its economic difficulties. Li Ruogu suggested that to improve its trade balance with China, the U.S. “should concentrate on sectors like aerospace and then sell those things to us and we would spend billions on this. We could easily balance the trade.”<sup>2</sup> Chinese Premier Wen Jiabao made this plea directly to President George W. Bush during their December, 2003 summit, and President Hu Jintao will undoubtedly also do so during his upcoming Washington summit.

I attended the 5<sup>th</sup> International Aviation and Aerospace Exposition held in Zhuhai, China just a few weeks before Li Ruogu's comment. Plenty of American firms were there trying to sell equipment to China. Boeing had a large display promoting its airliners, which featured a mural tracing the long history of business between Boeing and Beijing, and emphasizing the training and subcontracting Boeing had done with Chinese firms. At a press conference at the air show, Boeing predicted that China will be the world's second largest commercial aviation market after the United States, flying a 2,800-strong fleet of planes within 20 years. Chinese airlines are expected to buy nearly 2,300 new airliners by 2023 and will spend some \$183 billion to quadruple their current fleets. But even deals on this scale, paid out over 20 years, will not make much of a dent in an annual trade imbalance that topped \$200 billion just for 2005.

The United States wants Boeing and other American aerospace firms to sell as much as possible to China's civilian aviation, but what Beijing really wants is military technology, which it is simply not prudent for Washington to allow. Sales of military or “dual use” technology might amount to billions of dollars over some time period, but not on anything like the scale needed to balance trade. For example, 2003 was a peak year for Russian arms sales to China, not just “dual use” technology, but entire weapons systems including fighters, missiles and warships. But the total was only \$5.1 billion.<sup>3</sup> The transfer of the knowledge from the sale of American technology to China would do more to narrow the military capabilities gap than the trade gap.

Some individual companies might make a profit if restrictions were lifted, but if they resulted in higher performance Chinese weapons, the cost that the U.S. economy would have to bear to offset Chinese gains would likely be greater by orders of magnitude. For example, Toshiba Machine sold four nine-axis and four five-axis milling machines to the Soviet Union in 1982-1984. The machines were used to make improved propellers for Soviet submarines which made them quieter and harder to detect. Toshiba Marine rang up \$17 million for the sales, but it cost the U.S. several billions of dollars— some estimates have run to \$10 billion or more, in an effort to regain the ability to track these improved Soviet submarines.<sup>4</sup> Private profit is not only a wholly inappropriate factor to weigh against national security, it is also an entirely inadequate factor in even purely monetary terms.

Beijing is eager to convert its growing economic clout into military power. The writings of Chinese military leaders and strategists are devoted to finding ways to defeat the United States in war. In a paper delivered in September 2003 at a conference on the Chinese military sponsored by the American Enterprise Institute, the Heritage Foundation and the U.S. Army War College, Jason Bruzdinski concluded from his survey of Chinese writings that “PLA [People’s Liberation Army] analysts are carefully studying the vulnerabilities of U.S. weapons, platforms and military systems...to develop operational methods to counter technologically superior adversaries in a future war.”<sup>5</sup> The Chinese know they must close the technology gap in at least some areas if they are to prevail. To do so they will not only need to “achieve a leap-forward style of development in defense and army modernization” as President Hu Jintao has put it, but acquire and incorporate foreign technology into their projects.

Beijing’s approach to building up its defense industry through trade was set out in the mid-1990s. Among the principles stated by Shun Zhenhuan, a senior researcher at the State Planning Commission, were to “win more foreign exchange” from commercial exports which could be used to buy advanced technology; “boldly attract the investment of foreign capital”; and “develop substitutes for import products or analyze foreign technology and master imported products as much as possible for reproduction and imitation.”<sup>6</sup> China’s theft of intellectual property is thus part of its national strategy and has reached what the office of the U.S. Trade Representative termed “epidemic” proportions in its 57 page chapter on Chinese trade barriers released last year.<sup>7</sup>

No clear line can be drawn between commercial and military technology in China, nor for that matter in any advanced economy. The aerospace sector in China is entirely in state-owned enterprises. In 1999, Beijing established ten new aviation corporations, splitting AVIC (Aviation Industry of China) into AVIC I and II, authorized to make investments and act as holding companies under the direct supervision of the central government. Generally speaking, AVIC I focuses on large- and medium-sized aircraft, both commercial and military; while AVIC II gives priority to smaller airframes, missiles and helicopters. At the Zhuhai airshow, it was common to see tactical fighters and airliners, cruise missiles and business jets, helicopter gunships and crop dusters, displayed side-by-side in company pavilions. But then the same could be said for Boeing in the United States, which builds both fighters and airliners; or EADS in

Europe, which is the continent's largest defense contractor and the builder of Airbus. The supply chains for all these large aerospace firms includes firms which make products for both civilian and military use. Indeed, the trend in recent years has been for defense contractors to use more "commercial off the shelf" (COTS) items developed in the private sector. To a great extent, the worldwide diffusion of much of this knowledge is inevitable due to the expansion of global commerce. However, there are still elements that need to be curtailed, such as the enhancements often needed to "militarize" COTS products. This means increased vigilance and monitoring is needed over both trade and investment. A narrowly defined munitions list is inadequate in a world of increasing "dual use" technology.

In principle, we have known since the end of World War II than there was a connection between commercial production and the defense industrial base. In 1950, the Defense Production Act (DPA) was adopted. The DPA allows the government to require any U.S. entity to accept and give priority to contracts or orders deemed "necessary or appropriate to promote the national defense." The DPA authority extends to any and all goods and services, not just weapons systems: it covers construction and transportation services and even commercial products such as information technology, food and apparel. This wider working definition of what constitutes the defense industry in an era of rapid change and "dual use" technology is reflected in the fact that the Secretary of Commerce administers the Defense Priorities and Allocations System (DPAS) that implements the DPA.

The DPA has been reauthorization twice during the Bush Administration, in 2001 and 2003. On June 5, 2003, Undersecretary of Defense for Industrial Policy Suzanne Patrick told the Senate Committee on Banking, Housing & Urban Affairs, "A strong domestic industrial and technology base is one of the cornerstones of our national security.... The authorities in this Act continue to be of vital importance to our national security." The DPA loses its value, however, if the resources upon which the nation's security depends are located in foreign countries beyond the reach of U.S. law. The same logic that tells us that protecting and sustaining our industrial base is vital to national security should lead us to act to prevent potential adversaries from expanding their industrial capabilities.

A new report by the RAND Corporation on the Chinese defense industry found it was more advanced than previously thought. The authors reported that, "China's emerging IT sector is not an officially designated part of China's defense-industrial complex; however, it is probably the most organizationally innovative and economically dynamic producer of equipment for China's military. And it is at the forefront of China's improving defense-production capabilities. Although IT enterprises are primarily (exclusively, in most instances) oriented toward domestic and international commercial markets, the PLA has been able to effectively leverage certain IT products to improve the military's command, control, communications, computers, and intelligence (C4I) capabilities—a critical element of the PLA's modernization efforts."<sup>8</sup> The report devotes its largest section to China's IT industry.

China has become the world's largest exporter of information and communication technology goods, according to data from the Organisation for Economic Co-operation and

Development (OECD), surpassing the United States.<sup>9</sup> China overtook the European Union and Japan in 2003, then its IT exports soared 46 per cent to \$180 billion in 2004 to surpass the US by more than \$30 billion—and that is not counting goods shipped through Hong Kong. The U.S. ran a \$38 billion trade deficit in high-technology goods in 2004, mostly due to the rising export power of China. The IT industry is another example of the guiding Chinese principle of “Jun-min jiehe”—combine the military and the civil, or how “peaceful development” can enhance military capabilities.

China’s IT industry has benefitted greatly from foreign investment and technology transfers which are then sustained by exports into the open U.S. market. In its December 2005 White Paper “China’s Peaceful Development Road” published by the PRC State Council, Chapter III is entitled “Developing by Relying on Its Own Strength, Reform and Innovation.”<sup>10</sup> In it, there is the assertion that “China will take a new road of industrialization— using the IT [information technology] industry to promote industrialization and letting industrialization support the development of the IT industry.” In this statement there is no hint of the frequently heard argument in the United States that industry, particularly heavy manufacturing, can be abandoned or moved offshore as the economy advances into advanced IT and related services. Beijing is clearly aiming for a diversified and balanced industrial base that will support its self-reliance and national strength, elements essential to great power status. And, of course, the White Paper urges other developed countries to “ease restrictions on technology export” to China to help Beijing achieve its goals.

Semiconductors or “computer chips” are critical components in everything from automobiles to weapon systems. U.S. companies created and dominated the semiconductor equipment and materials industries until the early 1980s, when Japan increased investment and its companies gained a greater market share in several critical equipment and materials technologies. During the 1990s, U.S. companies regained market position and currently share worldwide leadership with Japan. Tokyo, however, still dominates the key silicon manufacturing and lithography markets, especially after America’s last high-end lithography firm, Silicon Valley Graphics, was bought out by the Dutch company AMS Lithography in 2003.

Today, it is China that has been making substantial new investments in semiconductor manufacturing. Beijing has made this a priority for national and economic security reasons and plans to build as many as 20 multibillion-dollar manufacturing facilities over the next 5 to 10 years with substantial levels of foreign investment. The growing sophistication of China’s semiconductor manufacturing facilities, which has improved its ability to develop more capable weapons systems and advanced consumer electronics, has been fueled by China’s success in acquiring manufacturing technology from abroad. This is an area in which the U.S. needs to stay a generation or two ahead, but it is not clear that current policy will be able to maintain such a lead.

A 2002 report by the Government Accountability Office (GAO) found “U.S. policies and practices to control the export of semiconductor technology to China are unclear and inconsistent, leading to uncertainty among U.S. industry officials about the rationale for some

licensing decisions. Under the Export Administration Regulations pertaining to China, the general licensing policy is to approve applications, except those items that would make a direct and significant contribution to specific areas of China's military. We found that the United States approves most licenses for exports."<sup>11</sup> The GAO concluded "The current export control system has not effectively slowed China's ability to obtain billions of dollars worth of advanced semiconductor equipment as part of its national strategy to modernize its semiconductor industry." The GAO recommended that new export controls be developed, and that this be combined with a more detailed assessment of what foreign entities were providing China in the hope that diplomacy could be used to strengthen the international regime of export controls.

The multilateral Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies has not been as effective as the Coordinating Committee for Multilateral Export Security Controls (COCOM) system used during the Cold War. COCOM was scuttled by the Clinton Administration in 1994. Wassenaar has not affected China's ability to obtain semiconductor manufacturing equipment, in large part because the United States has not provided the strong leadership needed to make the system effective.

Washington has even been confronted with major problems in regard to the China arms trade with some of its closest allies. The United States and Israel announced last August 16 that they had signed a memorandum of understanding to ease disputes over past Israeli arms sales to China and to govern future arms trade between Israel and foreign countries. A joint Pentagon-Israeli Defense Ministry statement said the understanding is "designed to remedy problems of the past that seriously affected the technology security relationship between their defense establishments and which begins to restore confidence in the technology security area."<sup>12</sup> Though the terms of the agreement remain classified, it is reportedly based on Israel more closely adhering to U.S. interpretations of the Wassenaar rules.

Last October, the U.S. State Department launched a new initiative to ease Britain's access to American defense technologies. The effort is headed by John Hillen, the State Department's chief of political and military affairs, who oversees U.S. arms exports and technology transfers. It is an attempt to use administrative methods to get around Congressional reluctance to grant London limited exemptions to the U.S. International Traffic in Arms Regulation (ITAR) so that Britain can have access to some defense information without filing for export licenses. Clearly, the UK is America's staunchest ally, and there have been some vexing tech transfer problems on partnership projects like the Joint Strike Fighter. But there are legitimate concerns about its firms passing technology on to third parties.

There is a joint venture between China's Tsinghua University and the UK's University of Surrey is building a constellation of seven minisatellites – a class of satellites weighing between 101 and 500 kilograms – with 50-meter-resolution remote-sensing payloads. Later satellites in the series probably will have improved resolution. The Defense Department's annual report on the Chinese military stated "China seeks to become a world leader in space development and maintain a leading role in space launch activity....With ever-better satellites, China is becoming a peer in quality to the world's leading producers."<sup>13</sup> The Pentagon report also cites China's

advances in the development of the Long March rockets, which received help from American firms in a well-known scandal that highlighted the failure of adequate policing of export controls.

London has also been among those European state which have favored lifting the European Union ban on the sale of “lethal” military systems to China. Beijing has denounced the arms embargo as a “Cold War relic” but the embargo has nothing to do with the Cold War. It was imposed by the U. S. and the EU after the 1989 Tiananmen Square massacre when the Chinese communist government ordered its troops to kill hundreds of pro-democracy demonstrators in the capital and thousands more across the country. Washington launched a strong diplomatic effort last year that persuaded the EU to delay any lifting of the arms embargo, but it seems likely that it is only a matter of time before the EU goes ahead and opens the door for its major arms exporters to enter the Chinese market on an even larger scale than they have been doing under the guise of commercial, dual use or “non-lethal” transactions. This will further complicate export controls with our “allies” and also increase pressure from American firms to lift controls so they can better compete with their European rivals in China.

During the debate last summer over this issue, the Aerospace Industries Association stated that “We agree with every administration since 1989 that selling military technology to China is a bad idea. And we think Europeans - our friends and military partners - shouldn't sell arms to China either.”<sup>14</sup> But at the same time the AIA has opposed punitive action against EU firms that trade with China and has also expressed fear that “sales to China could give a European supplier such economies of scale that the supplier would be able to lower prices in competing against U.S. producers in other markets, and possibly even in the U.S. itself.”<sup>15</sup>

While threats in the U.S. Congress to impose sanctions against European firms that sell arms to China may have played a role in dissuading the EU to lift its embargo, firm-level sanctions on China for weapons proliferation to Iran have not worked.

On Jan. 3, 2005, the Bush administration accused six Chinese companies and one Chinese individual of violating the Iran Nonproliferation Act of 2000. All the entities will be blocked for two years from receiving U.S. government contracts, assistance, or sales of arms and munitions. Two of the sanctioned Chinese entities, Q.C. Chen and Wha Cheong Tai Co., were among five penalized in December 2004 for similar activities. Three of the others, China Great Wall Industry Corp., China North Industry Corp., and Zibo Chemet Equipment Corp., have been sanctioned on previous occasions. Thirty Chinese entities account for more than half of the 112 proliferation-related sanctions publicly announced by the Bush administration. Then Undersecretary of State for Arms Control and International Security John Bolton said in a Feb. 7, 2005 speech that the administration imposed sanctions 62 times against Chinese entities during its first term.<sup>16</sup>

Yet, there has been minimal impact on Chinese behavior. Sanctions need to move above the firm level to have any affect on Beijing. The firms involved are state-owned and are dealing in systems that are closely monitored at the highest levels of the Beijing regime. It is simply not credible to believe that arms-related trade between Iran and China is not a matter of state policy,

given Beijing's strong diplomatic support for the militant Tehran regime. Thus, China as a whole needs to be the target of sanctions that affect commercial as well as government transactions if sufficient U.S.-China trade is to be put at risk to gain Beijing's attention. Beijing's long record of aiding the military development of rogue states, including weapons of mass destruction and missile systems, is another indicator of why the United States must redouble its efforts to control the flow of technology to China that could aid either China's continued "rise" as a rival power or its ability to support other dangerous regimes that pose a threat to American interests.

Another, often overlooked source of technology flow overseas occurs when foreign technology workers are brought to the United States for training or as "temporary" employees in American firms, including firms that work on military or 'dual use' projects. In 2004 alone, over 20,000 H-1B visa recipients came to the U.S. from China as temporary workers. Associate Professor Edward JW Park of Loyola Marymount University has noted that these Chinese scientists and engineers are "an important threat if they take their skills and work experiences back to their home country or to the highest bidder in the global high technology industry. In the case of Chinese H-1B workers, the stakes have become extremely high as China becomes an important global competitor. The purchase of IBM's personal computer unit by Lenovo marked an important turning point in this regard as PRC moves beyond manufacturing for transnational companies from more developed countries, raising more than a few eyebrows in Washington."<sup>17</sup>

Honeywell Aerospace has an agreement with Aviation Industries of China (AVIC) to provide extensive training for AVIC's "best engineers" including bringing them to U.S. plants to learn about American technology firsthand.<sup>18</sup> This program is explicitly meant to improve Chinese capabilities.

To work with controlled dual-use technologies in the United States, foreign nationals and the firms that employ or sponsor them must comply with U.S. export control and visa regulations. The firms should, in many cases, hold what is called a "deemed export license," issued by the Commerce Department, which is supposed to be the equivalent to the kind of license required if the project the foreign national is working on was actually being sent out of the United States. In 2002, the GAO did a study of this practice and found that 73 percent of all deemed export licenses were for Chinese nationals and 90 percent of applications were for work in "electronics, computers and telecommunications and information security."<sup>19</sup> Unfortunately, the GAO also concluded "Commerce attaches security conditions to almost all licenses to mitigate the risk of providing foreign nationals with controlled dual-use technologies. However, according to senior Commerce officials, Commerce staff do not regularly visit firms to determine whether these conditions are being implemented because of competing priorities, resource constraints, and inherent difficulties in enforcing several conditions." The GAO also found that Commerce routinely granted licenses without much in a way of background checks.

Though government policy is based on the principle that national security trumps private commercial considerations, the constant pressure on a day-to-day basis within the Federal bureaucracy to expedite business works against the consistent implementation of the principle. A "business perspective" on export controls will thus likely mirror Beijing's views on the matter.



“The Chinese really don't do any lobbying,” said James Sasser, who served as U.S. ambassador to China during the Clinton Administration. “The heavy lifting is done by the American business community.”<sup>20</sup> For example, in the Winter 2005/06 issue of *The National Interest* foreign policy journal, Maurice Greenberg, the former chief executive of American International Group (AIG), which has major investments in China, argues that despite significant differences over “values” between America and China, “It is important that we never allow our trading and economic relations to become hostage to these differences.”<sup>21</sup> In other words, commerce should be considered an autonomous sector with no wider consequences to the balance of power. In the *Wall Street Journal* on January 17, 2006, Samuel Porteous, managing director of Navigant Consulting's Asian Litigation and Investigation Practice in Shanghai and Hong Kong, penned a column entitled “The National Security Threat to Free Trade.” Among his list of complaints about American fears of China was the Committee on Foreign Investment in the United States (CFIUS) which monitors the impact of foreign capital on national security. Porteous believes “the committee's mere existence can deter foreign investment in potentially sensitive areas.” A coalition of major groups, led by the Chamber of Commerce, National Association of Manufacturers, and the Business Roundtable, have become more vocal in championing commercial over national security concerns in foreign policy decision-making, including opposing the strengthening of CFIUS in the wake of China's attempt to take over the American Unocal oil company.<sup>22</sup>

Beijing is able to play on the academic notion of trade liberalization favored by globalized corporations which claims international commerce fosters universal progress. As the “Peaceful Development” white paper argues, “China sticks to the principle of mutual benefit and win-win cooperation.”<sup>23</sup> The “win-win” concept has become a staple of Beijing rhetoric and has been picked up by a number of major American business groups.<sup>24</sup>

The “win-win” concept runs afoul of history and is invalid. “The idea that economics is primarily a non-zero-sum game is a favorite conceit of tenured academics. It has little connection with reality.” notes Samuel P. Huntington, who then asks “Why are the economists out in left field? They are there because they are blind to the fact that economic activity is a source of power as well as well-being.”<sup>25</sup> It is China's quest to turn economic gain into international power than must guide government policy to rein in the more narrow and short-sighted dealings of private business.

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23. "China's Peaceful Development Road" p. 12.

24. For example, the 2005 Fortune Global Forum, which gathered together CEOs from many of the largest U.S. firms to meet with Chinese leaders in Beijing was based on the theme: "As the world's economic center of gravity shifts to Asia, the dynamics of the global economy are changing dramatically. Already a dominant force in trade, China will overtake the US to become the world's largest economy by mid-century....The focus of the 2005 Forum will be how multinationals can tap into the enormous potential of China and its Asian neighbors and prosper in the decades ahead." [http://www.timeinc.net/fortune/conferences/global05/global\\_index.html](http://www.timeinc.net/fortune/conferences/global05/global_index.html).

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